



Statement of the U.S. Chamber of Commerce

ON: THE IMPACT OF FINANCIAL REGULATORY
RESTRUCTURING ON SMALL BUSINESSES AND COMMUNITY
LENDERS

TO: THE U.S. HOUSE COMMITTEE ON SMALL BUSINESS

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DATE: SEPTEMBER 23, 2009

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance -- is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 112 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Chairman Velazquez, Ranking Member Graves, and Members of the Committee on Small Business, thank you for the opportunity to speak before you today about an issue of great concern to our members: the impact of financial regulatory restructuring on small businesses and community lenders.

The U.S. Chamber is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Each major classification of American business – manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Furthermore, the Chamber has substantial membership in all 50 states.

I'd like to begin my statement by stating clearly that the U.S. Chamber supports the Administration's goal of enhancing consumer protections. In fact, the Center for Capital Markets Competitiveness has been calling for regulatory reform that includes strong consumer protections since before the financial crisis. The financial crisis, however, certainly shined a light on the weaknesses and shortcomings of our outdated regulatory system, and millions of consumers and investors were harmed due, in part, to regulatory failures. Consumers need clearer disclosure and better information. They also need vigorous enforcement against predatory practices and other consumer frauds.

We oppose H.R. 3126, the Consumer Financial Protection Agency Act of 2009, because we believe it is the wrong way to enhance consumer protections and will have significant and harmful unintended consequences for consumers, for the business community, and for the overall economy.

We are particularly concerned that these unintended consequences may fall disproportionately upon small businesses. As such, the Chamber commissioned a study to examine the CFPB and its potential effect on small business access to credit, "The Impact of the Consumer Financial Protection Agency on Small Businesses."¹ The study was authored by Thomas Durkin, an economist that spent more than 20 years at the Federal Reserve Board, serving as Senior Economist in the Division of Research and Statistics.

As we officially release the study today, I am here to provide Members of the Committee with an overview of the study and its key findings. I would also like to briefly discuss the Chamber's key concerns with regard to H.R. 3126.

¹ The Impact of the Consumer Financial Protection Agency on Small Businesses [Hereinafter "Durkin Study"]. Available at www.uschamber.com/ccmc. Embargoed until September 23rd, 2009,

Small Businesses and the Economy

As you are well aware, businesses operating at a small scale of production and employment account for a substantial portion of U.S. jobs. The 5.9 million firms with fewer than 100 employees accounted for 35% of U.S. employment in 2006². In addition, small businesses play an important role in creating new jobs, keeping overall unemployment rates low, and providing an unemployment cushion when unemployment rises. In 2006, of the 800,000 businesses that created new jobs, 642,000 had fewer than 20 employees³. In fact, between 1987 and 2005, new firms accounted for most of the net job creation in the U.S. – 86.7% of which were start-ups with less than 20 employees.⁴

For many of these new firms, their ability to grow and create new jobs is heavily dependent upon their access to credit. Small firms typically have trouble borrowing money – either they cannot borrow, they cannot borrow as much as they need, and almost certainly cannot secure long-term financing available to larger companies. According to a Federal Reserve study⁵, almost 20% of firms with fewer than 20 employees did not even apply for loans because they expected to be denied. In 2003, when the credit markets were robust relative to today, of those that did apply for credit, at least one application was denied a third of the time. Of new start-up firms, almost 25% did not apply for credit because they expected to be denied, and of those that did apply, at least one application was denied more than half of the time.

Small Businesses Use Consumer Lending Products

In understanding the impact of the proposed CFPA, it is critical to recognize that the small business sector relies most heavily on consumer financial products. Standard sources of working capital such as lines of credit are used the least by small firms. Only 42.5% of self-employed individuals have a traditional loan, increasing to 59.1% for firms with 1-4 employees. That statistic jumps to 93.8% for businesses with 100-499 employees⁶.

² Durkin Study citing (Employments and Payroll data from Office of Advocacy, U.S. Small Business Administration, Firm Size Data, available at http://www.sba.gov/advo/research/st_06.pdf.)

³ Durkin Study citing (Latest Statistics (2005-2006) on the change in U.S. Business Employment are available at http://www2.census.gov/econ/susb/data/dynamic/0506/us_state_totals_emplchange_2005-2006.xls. More recent Census data on US businesses are not available.)

⁴ Durkin Study citing (John Haltiwanger, Ron Jarmin and Javier Miranda, “Business Dynamics Statistics Briefing: Jobs Created from Business Startups in the United States,” Ewing Marion Kauffman Foundation (January 2009), available at <http://ssrn.com/abstract=1352538>).

⁵ Durkin Study citing (Lieu N. Hazelwood, Traci L. Mach, and John D. Wolken, “Alternative Methods of Unit Nonresponse Weighting Adjustments: An Application from the 2003 Survey of Small Business Finances,” Federal Reserve Board- Finance and Economics Discussion Series, 2007-10, available at <http://www.federalreserve.gov/pubs/feds/2007/200710/200710abs.html>).

⁶ Durkin Study citing (Table A in “Small Business and Micro Business Lending in the United States, for Data Years 2003-2004,” Office of Advocacy, US Small Business Administration, November 2005)

For example, our study finds that personal credit card use is highly prevalent among small businesses as a supplement for traditional commercial lending that small businesses struggle to obtain. Additionally, Durkin cites the 2007 Survey of Consumer Finances⁷ that demonstrates that self-employed individuals often rely on home equity loans – and in fact families headed by a self-employed individual (20.4%) had larger amounts of debt secured by residential property on average than families overall (12.6%). As Durkin notes, author Hernando de Soto identifies home equity loans as the “single most important source of funds for new businesses in the United States.”⁸

In addition, small businesses use consumer credit products that might be considered “fringe” financial products to meet their needs for immediate short-term capital. For example, auto title loans provide small business owners with immediate access to cash and no up-front fees or prepayment penalties – thus uniquely useful in meeting short term capital needs that will be repaid in a short timeframe. For small businesses owners, relatively higher interest rates are an acceptable cost for the utility of the title loan.

To conclude, Durkin asserts that small businesses rely extensively on consumer lending products and use them as a source of credit in very different ways than consumers. As an example, small businesses are less likely to use their credit cards on a revolving basis than regular households – in fact 70.7% of business owners with no employees pay their balances at the end of the month, compared with only 53.8% for consumers⁹.

CFPA Impact on Small Business

Durkin concludes that the proposed Consumer Financial Protection Agency would result in reduced access to credit for small businesses.

First, the author states that the CFPA will likely “cause disruptions in consumer credit markets due to extensive legal uncertainty arising from provisions of the proposed Act.” Specifically, the bill would apply an unclear “abusive” standard to allow the CFPA to prohibit products and practices, but there are no existing legal precedents for guidance about how to interpret “abusive.” This would in turn create significant legal uncertainty regarding products and practices and their compliance with the law, creating disincentives and higher costs associated with products – particularly new products.

⁷ Durkin Study citing (Table 13 B in Brian Bucks, Arthur Kennickell, Traci Mach, and Kevin B. Moore, “Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances,” Federal Reserve Bulletin February 2009, available at <http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf>.)

⁸ Durkin Study citing (Hernando de Soto, *The Mystery of the Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (Basic Books, 2003) at 6; reprinted by The New York Times, Online Edition, available at <http://www.nytimes.com/books/first/d/desoto-capital.html>).

⁹ Durkin Study citing (Federal Reserve Board, Survey of Consumer Finance, 2007, available at <http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html>.)

As an example of the costs associated with legal uncertainty in regulation, Durkin highlights the passage of the Truth in Lending Act (TILA) and subsequent uncertainty over its legal interpretation. Conceptually, the Truth in Lending Act is relatively simple – disclose the costs and other terms of credit in a “clear and conspicuous manner” with federal preemption of state actions in the area. However, due to legal uncertainty surrounding provisions of the legislation, a week before its effective date in 1969, there were 34 official interpretations of the regulation, by June 1979 more than 13,000 Truth-in-lending lawsuits had been filed in Federal courts (up to 50% of the caseload in some districts), and by early 1980, the Federal Reserve Board had published 1500 official interpretations with varying degrees of legal authority¹⁰. Despite TILA’s straight-forward objective and wide support, legal uncertainty led to the expenditure of significant resources by creditors to ensure compliance.

Further, the CFPA Act gives the states, as well as localities, the authority to issue more restrictive consumer protection regulations than those adopted by the CFPA. As a result, lenders would be newly subject to varying regulations and litigation exposure across the 50 states.

Taken together, Durkin concludes that the CFPA would create considerable new risks to lenders of regulatory fines and litigation from extending credit. This would increase the cost to lenders of making credit available, and create pressure for lenders to raise prices on consumer credit products. Durkin also concludes that the CFPA would cause lenders to withdraw some credit products from the market. Lenders need to expect that revenue will exceed the expected costs of a product before it is offered, with enough of a profit to remain competitive. If increases in fees or interest rates are not enough to compensate for higher costs, the products may be pulled. In addition, the CFPA would require lenders to offer standardized products to consumers before or at the same time as the lender offers its own, alternative products. A standard, government approved product may siphon customers away from alternative products, making it unlikely the lender will continue to offer anything but the standard product.

Therefore, small businesses as users of consumer financial products, would also likely have less credit available to them at higher prices.

Small businesses need a flexible set of credit products that meet the short term fluctuations in their credit needs without a long outstanding line of credit. These factors give them a different risk profile and credit needs than a consumer, yet the CFPA adopts a one-size-fits all approach to credit products. By encouraging standardized products, the CFPA will seek to respond to the “average consumer.” However, it is likely CFPA regulations will cover all

¹⁰ Durkin Study citing (Ralph J. Rohner, ed. *The Law of Truth in Lending* (Boston: Warren, Gorham and Lamont, 1984). See also, Jonathan M. Landers, *The Scope of Coverage of the Truth in Lending Act*, American Bar Foundation Research Journal (Volume 1, Number 2, 1976) and Jonathan M. Landers and Ralph J. Rohner, “A Functional Analysis of Truth in Lending,” *UCLA Law Review*, April, 1979.)

consumer lending products regardless of whether they are used by small businesses – small businesses that have different needs and a different risk appetite than the “average consumer.”

Finally Durkin asserts that small businesses, despite not being consumers and therefore a clear target of the legislation, would face collateral damage from the CFPA. They would likely have less access to credit – not for consumption – but for building and operating their businesses. For the credit they can obtain, it will come at a higher cost. The result will be fewer start-ups and slower growth for small businesses, business closures, and importantly, a significant reduction in jobs – both by eliminating current jobs and preventing new job creation.

In sum, a new regulatory regime that adversely impacts small businesses with higher costs and new financial difficulties through unavailable products is simply the wrong remedy at the wrong time.

Key Concerns with H.R. 3126

Legislation to enhance consumer protection should focus on ensuring disclosures to consumers are transparent, understandable and concise; improving consumer education; enhancing the ability of consumers to choose between competing products whose terms are well disclosed and truthfully conveyed; and ensuring strong and consistent enforcement to deter and punish illegal and predatory activities.

Because we do not believe that the proposed Consumer Financial Protection Agency will achieve these objectives, we oppose legislation to create it.

Scope

The Chamber recently joined with 24 other trade associations representing vast sectors of the business community to express concern regarding the scope and regulatory authority of the CFPA – from advertising agencies to homebuilders to real estate service providers. The definitions included in Section 101 of the bill vastly expand the scope of the CFPA to businesses that simply extend credit to their customers – whether through accounts receivable, lay-away programs, installment plans or even a “tab” payable at the end of the month. In addition, the bill would cover any entity that provides a “material service” to a provider of consumer financial products, or that is in anyway “indirectly” engaging in a financial activity, broadly defined, with a consumer. This would include technology providers, communications, accountants, advertisers, shipping service providers, and several others.

In addition, the CFPA would have authority over all aspects of a covered entity’s business practices, not just the consumer transaction. Ultimately, this will impose significant new costs on businesses for which “consumer finance” is well outside their core business. I’d like to submit the industry letter dated September 18, 2009, for the record.

Safety and Soundness vs. Product Regulation

Separating the regulation of financial products from regulatory expertise regarding the underlying financial institutions and related regulatory goals such as safety and soundness is neither pro-consumer nor effective. In fact, dividing these responsibilities will only increase the likelihood that key issues related to consumer protection will fall through the cracks – exacerbating a fundamental weakness of our current system, which is already unduly fragmented. In addition, there is no dispute mechanism in the bill to address potential conflicts when a safety and soundness regulator disagrees with a CFPA regulation – what is considered “low risk” for consumers may in fact pose significant risks to the health of the institution and the stability of the financial system.

Lack of Preemption

At a time when harmonization has been identified by all stakeholders as a goal of regulatory reform, the proposed new Agency will do exactly the opposite. Rather than adopting a new national standard and preempting multiple and conflicting state laws, the new agency would set the floor, creating inconsistencies, duplications, and conflicting mandates between the federal and state agencies. In fact, the bill even rolls back 150 years of banking law by subjecting national banks for the first time to state consumer protection mandates. Further, a separate consumer protection agency will foster uncertainty and encourage regulatory arbitrage – the same kind of arbitrage that has been widely identified as a source of regulatory failures that contributed to the crisis.

To make matters worse, the bill explicitly authorizes state attorneys’ generals (“State AGs”) to enforce federal mandates.

Small Institutions will be Disadvantaged

The legislation nationalizes consumer finance by requiring institutions to offer government mandated products or “plain vanilla” products. The government does not have the market insight or expertise to design financial products that respond to consumer demand at an efficient price. In addition, the CFPA would discourage many financial institutions, especially small institutions, from offering alternative products tailored to meet consumer needs. In a market dominated by a government mandated product, the legislation would give large institutions clear advantages over smaller competitors that cannot as easily absorb the additional costs of offering, marketing and distributing non-“plain vanilla” products – let alone offer them at a competitive price. For small businesses that rely heavily on their community banks for credit products, the result will be disproportionately harmful.

Federal Stamp of Approval

The government cannot, nor should it aim to, regulate risk out of financial products. Consumers benefit from having and making well informed, clear choices about which products serve their needs. While the primary goal of consumer protection regulation should be to thwart abusive practices and deter fraud, we cannot ignore the need to also encourage and facilitate consumers conducting their own due diligence in reviewing products to determine which are best for them and their appetite for risk. Putting a federal stamp of approval on consumer products only reduces such incentives by signaling that these products are safe and free from potential loss.

Another Regulatory Layer

Furthermore, H.R. 3126 adds another regulatory layer – both to existing federal agencies and to state regulation – that will inevitably stifle innovation. Consumer product providers need the ability to create new pro-consumer products, propose them to regulators, and get a timely and effective review.

Removes Important Checks on FTC's Authority

The legislation would replace the Federal Trade Commission's (FTC) rule-making authority under the Magnuson-Moss Act with the expedited processes of the Administrative Procedures Act (APA). Magnuson-Moss was intended to provide procedural protections for affected industries and other groups under the extraordinarily broad jurisdictional reach of the FTC. This provision removes an important check on FTC's rule-making authority. In addition, this would occur against the backdrop of the unprecedented and broad rule-making and civil penalty authority the legislation grants to the FTC that would enable it to regulate most industries with little oversight and no recourse for affected industries.

Unnecessary and Costly Litigation

H.R. 3126 will needlessly increase the costs and inefficiencies of private litigation by granting the CFPA authority to prohibit mandatory arbitration clauses. Arbitration has proven repeatedly to be an efficient and effective alternative to the costly and inaccessible court system. Furthermore, courts and regulators already possess and exercise broad authority to ensure the fairness of arbitration processes. In addition, Section 1042 of H.R. 3126 authorizes state attorneys' generals to sue for violations of any provisions of the bill or regulations promulgated there under.

Conclusion

Again, thank you for the opportunity to speak before you today. I look forward to working with Members of this Committee and your colleagues to craft legislation that protects consumers – but in a way that also protects economic opportunity and consumer choice.